

**STATE OF ILLINOIS**  
**ILLINOIS COMMERCE COMMISSION**

Illinois Commerce Commission	)	
on its own motion	)	Docket No. 01-0705
	)	
Northern Illinois Gas Company d/b/a NICOR	)	
Gas Company	)	
	)	
Reconciliation of Revenues collected under	)	
Gas Adjustment Charges with Actual Costs	)	
prudently incurred	)	
	)	
Illinois Commerce Commission	)	
on its own motion	)	Docket No. 02-0067
	)	
Northern Illinois Gas Company d/b/a NICOR	)	
Gas Company	)	
	)	
Proceeding to review Rider 4, Gas Cost, pursuant	)	
to Section 9-244(c) of the Public Utilities Act	)	
	)	
Illinois Commerce Commission	)	
on its own motion	)	Docket No. 02-0725
	)	
Northern Illinois Gas Company d/b/a NICOR	)	
Gas Company	)	
	)	
Reconciliation of Revenues collected under	)	
Gas Adjustment Charges with Actual Costs	)	
prudently incurred	)	

**REDACTED**

**REBUTTAL TESTIMONY ON REOPENNING**  
**OF**  
**RICHARD J. ZURASKI**

**Senior Economist**  
**Illinois Commerce Commission**  
**Energy Division—Policy Section**

**February 27, 2004**

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**I. Witness Qualifications**

**Q. State your name and business address.**

A. Richard J. Zuraski, Illinois Commerce Commission, 527 East Capitol Avenue,  
Springfield, Illinois, 62701.

**Q. Are you the same Richard J. Zuraski that provided Direct Testimony on Reopening  
in this consolidated docket, on behalf of the Staff of the Illinois Commission  
Commission (“Staff”)?**

A. Yes.

**II. Purpose of Rebuttal Testimony**

**Q. What is the purpose of your rebuttal testimony on reopening?**

A. I will be responding to the rebuttal testimony presented by Nicor witnesses on or  
about January 16, 2004.

**Q. Please describe Attachments 1 through 3 to your rebuttal testimony.**

A. Attachments 1 and 2 are revised versions of the first two attachments to my direct  
testimony. They show Staff’s proposed refunds and proposed changes to the  
computation of PBR savings. The revisions reflect the correction of an error that came to  
my attention in reviewing the rebuttal testimony of Mr. Barrett. The error was an  
inappropriate deduction for virtual storage in my original restatement of Storage Credit  
Adjustment withdrawals, and is discussed on page 29, below. Attachment 3 is a copy of  
some of Nicor’s “Buckets” Reports, provided to Staff in discovery. I refer to these on  
page 41.

**III. Reliance on Deposition Testimony**

**Q. Please explain why your direct testimony contains quotations from the deposition transcripts.**

A. I provided the quotations from the deposition transcripts because I relied, in part, on the deposition testimony when formulating my opinions.

**Q. Are deposition transcripts the type of information that you, or other Staff witnesses, typically rely upon in proceedings at the Commerce Commission?**

A. Yes, this is the type of information I rely upon when performing analyses for the Commission. That is, Staff witnesses generally rely upon information provided by utility employees through discovery. Typically discovery is conducted through data requests. Thus, typically, I rely upon the information provided by utility employees in data request responses. In this docket, depositions were taken of Company employees, as well. Thus I relied upon deposition testimony as well as written data request responses.

**Q. What if anything about the deposition testimony makes you believe that it is reliable such that you would base your opinion upon it?**

A. I expect Company employees to provide honest and accurate information in response to discovery in docketed matters, whether it is in the form of data request responses or depositions. In the Commission discovery process, data requests are sent to utilities addressed either specifically to a particular witness or to the utility in general. A utility employee who has knowledge of the area of inquiry provides responses. Similarly, during the depositions taken in this case, Staff and intervenors posed questions to Company employees who either had knowledge in the area being inquired about, or who responded that they did not know the answer to the question.

Furthermore, unlike utility personnel providing data request responses, the deponents took an oath to tell the truth prior to their depositions. Thus, the deposition testimony cited in my testimony would seem at least as reliable as the discovery normally relied upon by Staff.

**IV. Reply to Nicor Witness Feingold**<sup>1</sup>

**A. The Regulatory History and Approval Process**

**Q. Mr. Feingold insists that the focus of the regulator’s attention should be on the utility’s results under PBR and not on micro-managing the utility’s individual decisions with the benefit of perfect hindsight.<sup>2</sup> He further instructs the Commission that it “should, and indeed must, evaluate the utility’s results that were achieved under the PBR by measuring the utility’s performance against the established benchmark.” Do you agree?**

**A.** From my perspective, there is great value in avoiding hindsight review, whenever possible. However, such restraint should not apply when dealing with a utility that used deceit in order to establish a PBR benchmark or sharing rule, or in the subsequent calculation of the benchmark or accounting for costs. Furthermore, a review of records and calculations to correct errors in a PBR benchmark or in the accounting of costs is not the type of “hindsight review” that I would condemn.

**B. Accusations of Fundamental Flaws**

**Q. Mr. Feingold accuses you of proposing adjustments that are “fundamentally flawed**

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<sup>1</sup> Nicor Exhibit 6.0

<sup>2</sup> Nicor Exhibit 6.0, p. 9.

65 **on regulatory and conceptual grounds within the context of the GCPP.” Does he**  
66 **provide any examples of your adjustments that he considers to be fundamentally**  
67 **flawed?**

68 A. He provides two examples of my adjustments that he considers to be  
69 fundamentally flawed.

70 First, he cites my proposal that the Commission modify the share the savings  
71 formula for 2000 and 2002 to eliminate the Company’s share of LIFO-derived savings  
72 (those savings due specifically to the difference between the contemporary market price  
73 of gas and the inventory price applied to net withdrawals from storage). The effect of my  
74 proposed adjustment is a refund to customers of about \$20.8 million (that is, one-half the  
75 post-restatement LIFO-derived savings of about \$41.7 million). The fundamental flaw,  
76 according to Mr. Feingold, is that “This is an example of retroactive ratemaking at its  
77 worst.”<sup>3</sup>

78 Second, he cites my proposal that the Commission order an additional adjustment  
79 associated with the increase in gas costs in 2000 resulting from the Company’s December  
80 1999 IMD storage transaction.<sup>4</sup> The fundamental flaw, according to Mr. Feingold, is that  
81 I relied on “perfect hindsight of the future price of gas” to support the adjustment.<sup>5</sup>

82 **Q. Will you be offering an opinion concerning Mr. Feingold’s interpretation of your**  
83 **proposed adjustment as “retroactive ratemaking at its worst”?**

84 A. No. Staff counsel considers this to be a legal issue, which they reserve the right

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<sup>3</sup> Nicor Exhibit 6.0, p. 5.

<sup>4</sup> Nicor Exhibit 6.0, p. 23.

<sup>5</sup> Nicor Exhibit 6.0, p. 23.

to address within briefs.

**Q. With respect to your additional adjustment associated with the increase in gas costs in 2000 resulting from the Company's December 1999 IMD storage transaction, how do you respond to Mr. Feingold's claim that it relies on perfect hindsight?**

A. While the computation of the adjustment is based on hindsight, the rationale for the adjustment is not. The rationale for the adjustment is that Nicor Gas transferred to IMD a significant amount of gas held in inventory just prior to the PBR program's start date. This net withdrawal enabled the Company to completely eliminate the two high-priced storage inventory layers that existed as of the beginning of 1999, and positioned the Company to begin withdrawing the much lower-priced gas in the pre-1984 layers of the inventory during the tenure of the PBR program. Also, the sale took place at the beginning of the winter and at a time when gas prices were expected to be rising (judging by futures prices at the time of the sale).

Hindsight was used to compute the actual harm that the Company's decision caused, net of adjustments already made by the Company in its restatement. Prices did rise throughout 2000, and ratepayers ended up paying more when the gas (originally sold to IMD in December 1999) was subsequently bought back at higher prices. As reported in my direct testimony, had the Company withdrawn the gas during the first quarter of 2000, rather than in December 1999, and waited to transfer the capacity to IMD until the second quarter of 2000, Nicor would have avoided about \$6.3 million in costs, less the \$3.6 in profit sharing it got back from IMD, leaving \$2.7 million. Based on this computation, I recommend a cost disallowance for 2000 of \$2.7. Given the 50-50 sharing formula, this adjustment leads to a refund to customers of about \$1.35 million.



If the Commission finds it more likely than not that Nicor timed this transaction to maximize the Company's share of PBR "savings," regardless of the expected effect the transaction would have on ratepayers, the proposed \$1.35 million adjustment is a reasonable means of computing the actual effect.

**Q. In reference to your \$1.35 million adjustment (associated with the Company's December 1999 IMD storage transaction) and to Mr. Mierzwa's adjustment in connection with the Aquila weather insurance deal, Mr. Feingold opines, "the GCPP review process should focus on results, not on individual decisions."<sup>6</sup> What is your reaction to this statement?**

A. Mr. Feingold's statement is not pertinent to the two adjustments in question. First, it is Staff's opinion that the December 1999 IMD transaction was not made under the auspices of the PBR program and therefore should not be exempt from prudence review. Second, regardless of whether or not there is a PBR program in effect, the PGA should not be placed at risk by non-PGA transactions like the Aquila weather insurance deal. Weather insurance that benefits the Company is not a gas cost and is not permitted by the Commission's PGA rule to be included in the PGA. Any attempt to directly or indirectly include such weather insurance costs in the PGA will be opposed by Staff.

**C. Aquila Deal Involving Weather Insurance<sup>7</sup>**

**Q. As you just noted, Mr. Feingold objects to Mr. Mierzwa's recommended additional \$2.1 million adjustment associated with the Company's deal with Aquila to trade a**

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<sup>6</sup> Nicor Exhibit 6.0, p. 24.

<sup>7</sup> Nicor Exhibit 6.0, p. 23.

gas sale discount (to Aquila) for a weather insurance discount (for Nicor shareholders). You also recommended an additional adjustment (\$2,057,525) associated with the Aquila weather insurance deal. Have Mr. Feingold's objections caused you to alter your recommendation with respect to this additional adjustment?

A. No. I still recommend, consistent with both the Lassar Report and Mr. Mierzwa, that Nicor be ordered to refund to ratepayers an additional \$2,057,525, associated with the Aquila weather insurance deal. My reasoning for this recommendation was fully explained in my direct testimony.<sup>8</sup> Furthermore, Mr. Feingold should consult with Nicor witness Moretti, who now proposes an additional refund of roughly the same magnitude (\$2.05 million) "related to the purchase of weather insurance from the company called Aquila."<sup>9</sup> I find it particularly ironic that Mr. Feingold elsewhere chides Staff and intervener witnesses for having varying views on some of the issues,<sup>10</sup> while he himself is 180 degrees apart from one of his client's other witnesses.

**D. Inclusion of NGPL Storage Withdrawals in the SCA Calculation**

**Q. Mr. Feingold states, "Staff witness Zuraski is incorrect in his assumption that the Company's gas volumes associated with the storage management services it received during the historical period were included in the Company's PGA mix at that time."<sup>11</sup> Do you know what he is talking about?**

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<sup>8</sup> ICC Staff Exhibit 1.0, pp. 68-76.

<sup>9</sup> Nicor Exhibit 10.0, especially p. 2, lines 36-37.

<sup>10</sup> Nicor Exhibit 6.0, pp. 72-75.

<sup>11</sup> Nicor Exhibit 6.0, p. 48.

147 A. No. I never made a claim like that.

148 **Q. Mr. Feingold notes that prior to the GCPP, the Company regularly released its own**  
149 **capacity, including NSS.<sup>12</sup> Does this alter your recommendation?**

150 A. No. My computations were based on the historical amount of purchased storage  
151 that the Company included in its accounting of Company storage volumes (1995-1998).  
152 To the extent to which gas was released prior to the GCPP and was not included in the  
153 Company's accounting of Company storage volumes, it was similarly not included in the  
154 total NGPL storage volumes that I included in the SCA. Thus, NSS volumes that had  
155 been released during the period 1995-1998 were not included in my computations.

156 **Q. Mr. Feingold states that you "would restrict the Company from making any**  
157 **changes to its gas supply portfolio that were not in effect during the historical**  
158 **period upon which the GCPP was based."<sup>13</sup> Is that true?**

159 A. Absolutely not. Indeed, I acknowledged in my direct testimony that "The  
160 Company may have been counting on the third parties to better manage the storage  
161 resources and create savings opportunities through such improved management."<sup>14</sup> I  
162 have no qualms with the Company's third-party storage management strategy. My only  
163 objection is to the exclusion of those volumes from the SCA component of the  
164 benchmark. The full rationale for this position was articulated in my direct testimony<sup>15</sup>  
165 and will not be repeated here in detail. Briefly, though, these volumes should have been

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<sup>12</sup> Nicor Exhibit 6.0, p. 46.

<sup>13</sup> Nicor Exhibit 6.0, p. 48.

<sup>14</sup> Staff Exhibit 1.0, p. 50.

<sup>15</sup> Staff Exhibit 1.0, pp. 60-65.

included in the SCA because the Company was still expected to benefit from the use of those storage volumes.

**Q. Mr. Feingold also states, “I can only conclude that since [Mr. Zuraski] recognizes that the gas volumes in question are, in fact, not storage withdrawals, his proposed adjustment is nothing more than a weak attempt to impute to customers the transactional benefits of a third-party deal that properly belong to the Company and IMD.”<sup>16</sup> Is Mr. Feingold correct?**

**A.** No. In this third-party deal, Nicor indirectly made use of storage resources that were included in the Company’s portfolio just prior to the beginning of the PBR program. The Company should not be permitted to hide withdrawals from the view of the PBR benchmark simply by entering into third-party deals. Hence, rephrasing to correct Mr. Feingold’s assessment, my proposal is actually an “attempt to impute to customers *one-half* the transactional benefits of a third-party deal that properly belong to the Company (and IMD) *and ratepayers, in accordance with the 50-50 sharing rule approved by the Commission in Docket 99-0127.*”

**Q. Mr. Feingold concludes by saying, “the Company was not at all motivated at this time to decrease its storage withdrawals through the IMD transaction so it could raise the GCPP Benchmark to create additional savings.”<sup>17</sup> Do you agree?**

**A.** While I do not know how he can be sure of his statement, I neither agree nor disagree with Mr. Feingold’s judgment of Nicor’s motivation. For my part, I already

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<sup>16</sup> Nicor Exhibit 6.0, p. 49.

<sup>17</sup> Nicor Exhibit 6.0, p. 50.

acknowledged that “The Company did not necessarily adopt this strategy simply to alter the benchmark.”<sup>18</sup> For all I know, people at the Company may still believe that these volumes should not be included in the SCA. I am merely offering my opinion that the benchmark would be more accurate with these volumes than without these volumes.

**E. Inclusion of In-field Transfers in the SCA Calculation**

**Q. Mr. Feingold disagrees with your recommendation to not make adjustments for “in-field transfers.” He acknowledges one of your arguments: specifically, that, in Docket 99-0127, the Company did not exclude in-field transfers from its computation of the commodity adjustment, which would have been lower had in-field transfers been excluded. His only rebuttal to your argument is that “The Commodity Adjustment approved by the Commission incorporated many factors and cannot be characterized as an exact representation of the differences between index costs and actual costs.”<sup>19</sup> How does this statement affect your recommendation?**

**A.** It does not cause me to change my recommendation. None of the components of the benchmark can be argued to be “an exact representation” of anything. That does not authorize Nicor to unilaterally add things to raise the benchmark, so Nicor can show and share in higher “savings.”

**F. Carrying Charges**

**Q. Mr. Feingold objects to your proposed adjustment to remove from the PGA explicit**

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<sup>18</sup> Staff Exhibit 1.0, p. 50.

<sup>19</sup> Nicor Exhibit 6.0, p. 52.

and implicit carrying charges embedded in the price of gas bought from third parties using Nicor's released storage capacity. Mr. Feingold states,

**I would first point out that if there were “explicit” carrying costs included in the price of gas charged to the Company under those transactions, Staff witness Zuraski apparently could not find them, as he provides no evidence of such costs. Regarding the existence of any “implicit” carrying costs, Staff witness Zuraski once again provides no evidence that there were any such costs included in the price paid by the Company. The Company agreed to a price that was dependent upon many factors, including term, quantity, transportation costs, and other contractual issues. It is sheer speculation on his part to assume that there was an implicit carrying cost included in the gas price.<sup>20</sup>**

## How do you respond?

A. As evidence that the Company paid explicit and/or implicit carrying charges for the gas bought as part of the DSS managed storage deals, and that the Company expected to save itself (not ratepayers) from the incursion of such carrying charges, I cite the following:

- Company witness Lenart’s Appendix A (“Performance Based Rates Strategies and Values FPC Meeting – November 29, 1999”), attached to his rebuttal testimony, shows “Strategy Values” for managed NSS and DSS service, with a separate estimate of “carrying cost savings of approximately” \$1.1 million and \$1.5 million, respectively.
- Another company document, entitled “DSS Management Potential Benefits and Risks,” lists under “Benefits,”

X  
X  
X  
X X

<sup>20</sup> Nicor Exhibit 6.0, p. 58.

[illegible]

- A January 10, 2000 memorandum from former Nicor vice president, Lonnie Upshaw, under the heading, “DSS Management Service,” states, in part, “[REDACTED]”
- [REDACTED]
- [REDACTED],<sup>22</sup>
- Documents provided to Staff during discovery show that the deal with IMD to manage DSS [REDACTED]
- [REDACTED]<sup>23</sup> In both 2000 and 2001, this resulted in a portion of IMD’s carrying charges being included in the fees paid by Nicor and recovered through the PGA.<sup>24</sup>
- Finally, Company witness Moretti, in his rebuttal testimony, proposes to flow through the PGA an additional refund of \$4.1 million, conceding that “\$2.05 million is related to carrying costs paid to the entity known as IMD as part of its cost to manage Nicor Gas’ DSS storage.”<sup>25</sup>

<sup>21</sup> NIC 003205.<sup>22</sup> NIC 005797-8.[illegible]

<sup>24</sup> Due to the profit sharing arrangement in place between IMD and Nicor, this amounted to **xx** % of IMD's carrying charges associated with the released DSS capacity (based on data gathered from KPMG 027304-027305, 027599 and 027321).

<sup>25</sup> Nicor Exhibit 10.0, especially p. 2, lines 33-35.

**G. LIFO-Derived Savings**

**Q. Mr. Feingold criticizes your computation of LIFO-derived savings, stating, “Essentially, his resulting adjustment is based on the overly simplistic use of average annual gas prices in the market applied against the net withdrawals for each of the two years.”<sup>26</sup> How do you respond to this criticism?**

**A.** The use of average annual gas prices is neither “overly simplistic” nor overly complicated. In the Company’s LIFO accounting system, net withdrawals are computed on an annual basis. They are neither identified nor valued on a daily or monthly basis. Furthermore, any attempt to allocate net withdrawals on a daily or monthly basis would be arbitrary. When I first set out to compute the LIFO-derived savings, I considered several alternative computations. Most of them involved some form of allocation of the net withdrawals to various months in the year. However, I realized that any particular allocation would be arbitrary. To avoid a senseless debate over the allocation issue, I chose to adopt the simple average.

**Q. On page 30 of his rebuttal testimony, Mr. Feingold summarizes the result of his “independent analysis” of the market costs avoided by the net withdrawals from the low-cost LIFO layers. Details of that analysis are shown in his Attachment RAF-R1. Is his analysis in any way better than your analysis?**

**A.** No. In effect, Mr. Feingold’s analysis uses an arbitrary allocation of the annual net withdrawals (for 2000 and 2002) and annual net injections (for 2001). He assumes that net withdrawals (or net injections for 2001) were portioned equally over those

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<sup>26</sup> Nicor Exhibit 6.0, p. 26.



months in which withdrawals exceeded injections (or vice versa for 2001). He does this by taking the simple average of the market index prices that prevailed during those months in which Nicor Gas had net withdrawals (for 2000 and 2002) or net injections (for 2001). This simple average is multiplied by the annual net withdrawals (or injections) to get what he calls "Replacement Gas Costs" in RAF-R1. He subtracts from Replacement Gas Costs the product of annual net withdrawals (or injections) and the average cost of the LIFO layer(s) being depleted (for 2000 and 2002) or created (for 2001). In using this more complicated procedure, Mr. Feingold implicitly assumes that annual net withdrawals cannot be created simply by injecting less in those months where you have net injections, while annual net injections cannot be created simply with withdrawing less in those months where you have net withdrawals. He neither acknowledges nor states any basis for this assumption. Furthermore, even if one were intent on using only data from the net withdrawal months (in 2000 and 2002) and net injection months (for 2001), he states no basis for assuming that each of those month's prices should be weighted equally rather than in proportion to the relative size of gross or net withdrawals (or injections) in that month. Basically, Mr. Feingold has presented a more complicated analysis, but one that has no more theoretical or practical merit than the one that I presented.

**Q. With respect to your calculation of the LIFO-derived savings, Mr. Feingold criticizes you for excluding the effect of net injections that occurred in 2001 (after the accounting restatement).<sup>27</sup> Why did you exclude the 2001 net injections?**

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<sup>27</sup> Nicor Exhibit 6.0, p. 36.

295 A. As Mr. Feingold acknowledges, “when there is a net injection, the cost of that  
296 LIFO gas layer is equal to *the current cost of gas*.”<sup>28</sup> Hence, in theory, the savings  
297 associated with net injections, relative to “the current cost of gas” should be zero. Thus,  
298 there is no reason to include the 2001 net injections in the calculation of LIFO-derived  
299 savings.

300 Having said that, one should also realize that the market index prices that Mr.  
301 Feingold, Mr. Mierzwa, and I, relied upon for our LIFO-derived savings calculations, is  
302 not necessarily a perfect measure of “the current cost of gas” from Nicor Gas’ buying  
303 perspective. Indeed, the Company argued successfully in Docket 99-0127 that the  
304 market index price underestimates its gas costs, which is why there was a positive “firm  
305 deliverability adjustment” and a positive “commodity adjustment” added on top of the  
306 market index component of the PBR benchmark. Hence, the use of the PBR market  
307 index price is a conservative way of measuring the Company’s avoided cost of gas. For  
308 instance, for years 2000 and 2002, using the market index price underestimates the size  
309 of the LIFO-derived savings.

310 Inspection of the 2001 market index prices, shown in Mr. Feingold’s Attachment  
311 RAF-R1 (page 3 of 4), illustrates my point about the market index price underestimating  
312 the Company’s current cost of gas. In 2001, using Mr. Feingold’s average of only seven  
313 of the twelve months of market index prices (\$3.1627/MMBTU), the Company’s current  
314 cost of gas is \$1.97 higher than that average market index price (\$5.1341 minus \$3.1627).  
315 In my computations of the LIFO-derived savings, I used the simple average of all twelve  
316 months of market index prices. In 2001, using my simple average of all twelve months of

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<sup>28</sup> Nicor Exhibit 6.0, p. 36 (emphasis added)

market index prices (\$4.313/MMBTU), the Company's current cost of gas is still \$0.82 higher than that average market index price (\$5.1341 minus \$4.313). In comparison to Mr. Feingold's approach, my simple average approach provides a more accurate measure of the Company's average cost of gas in 2001. However, it is still an underestimate, leading me to have some confidence that I am conservatively underestimating the LIFO-derived savings in 2000 and 2002.

**Q. Mr. Feingold repeats a claim that was made in the Company's direct testimony on reopening, that "all parties in this proceeding knew of the existence of this LIFO gas, and its inherent value, at the beginning of the GCPP approval process."<sup>29</sup> How do you respond to this statement?**

A. I addressed this point in my direct testimony, specifically between pages 27-29 (lines 528-565). Mr. Feingold does not refute those lines from my direct testimony; he merely asserts that parties "have not supported their positions." Well, actually, I did, and I refer the reader to Staff Exhibit 1.0, pages 27-29 (lines 528-565).

**Q. Mr. Feingold further opines that Staff and intervenors' positions with respect to what they knew about LIFO "really appear to be a reaction to the fact that the Company did use its gas supply assets in an innovative way that they did not anticipate at the time."<sup>30</sup> How do you respond to this opinion?**

A. Staff's position is partly a reaction to the Company hiding the truth from Staff and

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<sup>29</sup> Nicor Exhibit 6.0, p. 36.

<sup>30</sup> Nicor Exhibit 6.0, p. 36.

the Commission.<sup>31</sup> However, the basis for Staff's LIFO recommendation is broader than that.<sup>32</sup> Primarily, the LIFO strategy did not reflect any improvements in efficiency or gas purchasing acumen. The LIFO strategy was more of a trick to take advantage of historical differences in market prices.

**Q. Mr. Feingold then frets, "If not careful, I could easily see the positions of the Staff and the Intervenors in this proceeding quickly gravitating to an extreme where they would claim that all possible new strategies and actions available to the Company should have been built into the GCPP Benchmark before its approval."<sup>33</sup> Should Mr. Feingold fear that the Staff's positions will gravitate toward such an extreme.**

**A.** I don't really see Staff's positions gravitating at this point. Staff's positions have already been articulated in direct testimony.

**H. Benefits Determination and Sharing Under the GCPP**

**Q. Mr. Feingold claims that Nicor Gas customers have received "distinct and long-lasting benefits under the GCPP." He cites how the Company outperformed the GCPP benchmark by \$17,746,399 over the three years. Are these long-lasting benefits, in your view?**

**A.** No. First, after the Staff's adjustments, the Company did not outperform the benchmark at all. Rather, the Company underperformed the benchmark by \$9,419,763.

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<sup>31</sup> See, for example, Staff Exhibit 1.0, pp. 33-34, where I state, "In Docket 99-0127, the Company could have made the LIFO strategy known to the Commission. It could then have made an argument for why the LIFO strategy's impact on risk should not affect the 50-50 sharing of LIFO savings. It could have sought the Commission's judgment, then. But to accept the Company's untimely arguments, now, would send the message that telling the Illinois Commerce Commission the half-truth and nothing but the half-truth is a viable and profitable tactic."

<sup>32</sup> See ICC Staff Exhibit 1.0, pp. 16-39.

<sup>33</sup> Nicor Exhibit 6.0, p. 37.

354 These are the total negative savings, and it includes the contribution to positive savings  
355 due to the decimation of old-LIFO layers.<sup>34</sup>

356 Second, as shown in Table 1 (next page), even if one accepts the Company's  
357 version of computed savings and Mr. Feingold's version of LIFO-derived savings, 183%  
358 of the total three-year savings were due to LIFO depletion, implying that all the  
359 Company's other strategies combined resulted in losses. Using the Company's version of  
360 computed savings and my version of LIFO-derived savings, 235% of the three-year  
361 savings were due to LIFO depletion, implying that all the Company's other strategies  
362 combined resulted in even greater losses.<sup>35</sup> As shown in Table 2 (next page), the results  
363 are even more dramatic if one accepts the Staff's version of total savings.

364 Of course the depletion of low-cost LIFO gas is not a long-lasting benefit. Once  
365 the low-cost heirloom layers are depleted from inventory, they are gone. Indeed, as  
366 noted on page 21 of my direct testimony, the depletion of LIFO layers through the  
367 Company's prefill strategy would eventually catch up to the Company. The inventory  
368 would be built up again using contemporary market-priced gas. The effect would be an  
369 increase in rate base during a future rate case.

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<sup>34</sup> More precisely, fourteen percent of the layers from 1971 and earlier were depleted.

<sup>35</sup> Note, however, that these figures do not incorporate the \$8.2 million reduction in the Company's version of savings implied by the additional \$4.1 million refund discussed by Mr. Moretti in his rebuttal testimony. Taking this further reduction in non-LIFO savings into account almost doubles the percentage of savings due to LIFO.

**Table 1. LIFO-Derived Savings  
as a Percent of Nicor's Revised Total PBR Savings**

	With Feingold LIFO-derived Savings			With Zuraski LIFO-derived Savings		
	Company's Total Revised PBR Savings	Feingold's LIFO-Derived Savings	Difference	Company's Total Revised PBR Savings	Zuraski's LIFO-Derived Savings	Difference
<b>2000</b>	(\$6,451,281)	\$17,337,441	(\$23,788,722)	(\$6,451,281)	\$22,031,074	(\$28,482,355)
<b>2001</b>	(\$29,554,060)	(\$3,992,334)	(\$25,561,726)	(\$29,554,060)		(\$29,554,060)
<b>2002</b>	\$53,751,739	\$19,089,842	\$34,661,897	\$53,751,739	\$19,658,357	\$34,093,383
<b>Total</b>	\$17,746,398	\$32,434,949	(\$14,688,551)	\$17,746,398	\$41,689,431	(\$23,943,033)
<b>%</b>	<b>100%</b>	<b>183%</b>	<b>-83%</b>	<b>100%</b>	<b>235%</b>	<b>-135%</b>

**Table 2. LIFO-Derived Savings  
as a Percent of Staff's Revised Total PBR Savings**

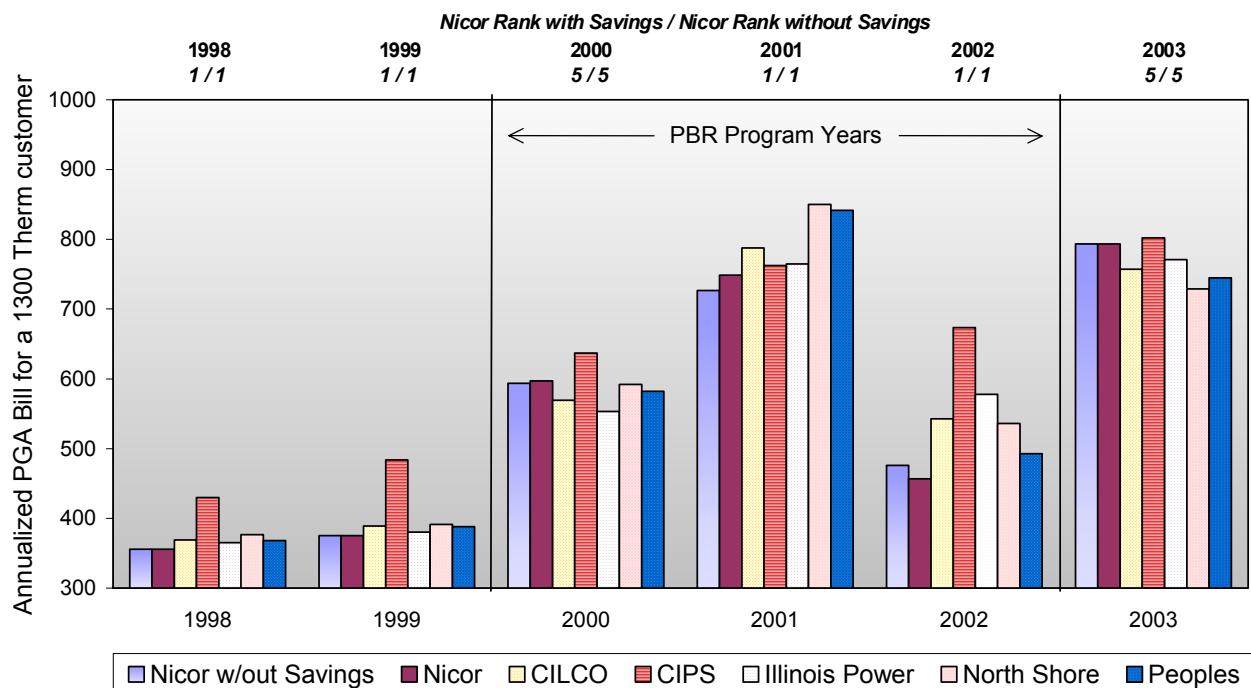
	With Feingold LIFO-derived Savings			With Zuraski LIFO-derived Savings		
	Staff's Total Revised PBR Savings	Feingold's LIFO-Derived Savings	Difference	Staff's Total Revised PBR Savings	Zuraski's LIFO-Derived Savings	Difference
<b>2000</b>	\$15,617,956	\$17,337,441	(\$1,719,485)	\$15,617,956	\$22,031,074	(\$6,413,118)
<b>2001</b>	(\$90,103,000)	(\$3,992,334)	(\$86,110,666)	(\$90,103,000)		(\$90,103,000)
<b>2002</b>	\$64,143,380	\$19,089,842	\$45,053,538	\$64,143,380	\$19,658,357	\$44,485,023
<b>Total</b>	(\$10,341,664)	\$32,434,949	(\$42,776,613)	(\$10,341,664)	\$41,689,431	(\$52,031,095)
<b>%</b>	<b>100%</b>	<b>-314%</b>	<b>414%</b>	<b>100%</b>	<b>-403%</b>	<b>503%</b>

**Q. Mr. Feingold cites the fact that the Company maintained its position as the lowest-cost provider of natural gas in Illinois as evidence that the GCPP provided distinct and long-lasting benefits. Do you agree?**

**A.** No. First, as I just mentioned, over the three years, even Nicor's numbers show that all the Company's positive savings can be attributed to the depletion of LIFO layers, which are not long-lasting. Second, as shown in Figure 1 below, even if the Company had had no PBR savings, it would have remained ranked exactly the same in relation to

other major Illinois utilities.<sup>36</sup> This is not a criticism of Nicor. It is merely a reflection of the fact that the savings, on a per therm basis, were relatively small in relation to the degree to which Nicor has been and continues to be a relatively low-cost provider of gas in the State.

**Figure 1. Showing that PBR “Savings” Had No Effect on Nicor’s Rank\* Among Five Other Illinois Utilities (CILCO, CIPS, Illinois Power, North Shore, Peoples Gas)**  
\* Ranked from Lowest to Highest Annualized PGA Rates



If anything, the data reveal that Nicor Gas has lost some ground to other Illinois utilities (with or without accounting for “savings”). Comparing the pair of years before the PBR program began, to the years after the PBR went into effect, Nicor Gas’ rank has slid upwards. In both 2000 and 2003, Nicor’s PGA slipped from being the lowest to being the second highest among the other five major Illinois utilities.

<sup>36</sup> For this analysis, I use the five other utilities that Mr. D’Alessandro used in his Direct Testimony (Nicor Exhibit

398 **Q. Mr. Feingold notes that Company witness D'Alessandro presented cost of gas**  
399 **information in his direct testimony indicating that Nicor Gas was among the lowest**  
400 **cost providers of natural gas in Illinois over the last five years. He then asserts,**  
401 **“During the three-year GCPP Period, the Company was the lowest-cost provider**  
402 **based on the total cost of gas charged to each of the utility’s sales customers.” Is**  
403 **that correct?**

404 A. I am assuming that by “total cost of gas,” Mr. Feingold is including base rates as  
405 well as PGA rates. In that case, he is correct; and his statement does help put things into  
406 perspective. However, the PBR program was about just PGA rates. So, if we limit our  
407 attention to the PGA, then, in comparison to five other large Illinois gas utilities, Nicor  
408 Gas was fifth lowest in 2000, and lowest in 2001 and 2002. Furthermore, as just  
409 mentioned in the previous question and answer, the Company was also fifth lowest in the  
410 first year following the PBR program (2003).

411 **I. Company’s Compliance with the GCPP Order**

412 **Q. Mr. Feingold seems to say that it is no longer appropriate and “a moot point” to**  
413 **review whether the GCPP is meeting its objectives.<sup>37</sup> Do you agree?**

414 A. Docket 02-0067 was initiated, pursuant to Section 9-244 of the Public Utilities  
415 Act, to determine if the GCPP was meeting its objectives. A final resolution of that issue  
416 has never been made. Nicor witness D'Alessandro, in his direct testimony on reopening  
417 even stated that “Nicor is seeking a determination from the Commission that the GCPP

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1.0, Attachment RJD-1).

<sup>37</sup> Nicor Exhibit 6.0, pp. 76-77.



met its goals...”<sup>38</sup> Hence, I am somewhat perplexed by Nicor witness Feingold’s position on the matter.

**V. Reply to Nicor Witness Barrett**<sup>39</sup>

**A. Reversal of LIFO Benefit**

**Q. In his opening remarks concerning the “Reversal of LIFO Benefit” section of his testimony, Mr. Barrett asserts that your proposed adjustments are “based on a faulty accounting premise, are inconsistent with what actually occurred, are not properly run though the required GCPP calculation, and rely on arbitrary assumptions, applied in a biased fashion.”<sup>40</sup> Will you be addressing each of these points?**

**A.** Yes, except that Staff accounting witness Mary Everson will also be addressing Mr. Barrett’s claim that the proposed adjustments are “based on a faulty accounting premise.”

**1. Faulty accounting premise**

**Q. Mr. Barrett states that it is “wholly incorrect to characterize LIFO accounting as some sort of accounting ‘trick’ as Mr. Zuraski has done.”<sup>41</sup> Did you do that?**

**A.** No. I think Mr. Barrett misinterpreted my testimony. I agree that LIFO is a legitimate method of accounting for inventories. The “trick” that I referred to in my direct testimony was the Company’s strategy of: (1) setting up prefill deals and a system

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<sup>38</sup> Nicor Exhibit 1.0 (D’Alessandro Direct), p.7.

<sup>39</sup> Nicor Exhibit 7.0

<sup>40</sup> Nicor Exhibit 7.0, p.7.

<sup>41</sup> Nicor Exhibit 7.0, p.8.

of prefill deal accounting to better control net withdrawals, and (2) using those net withdrawals from old LIFO layers to make it appear that the Company was being a more efficient gas purchaser (beating a PBR benchmark, composed primarily of contemporary price indices).<sup>42</sup>

**Q. Mr. Barrett says that you “seem to argue that the LIFO accounting allows the customers to acquire some ill-defined quasi-ownership interest.”<sup>43</sup> Is that your argument?**

A. No. Not at all. I do not argue that customers acquired a quasi-ownership interest in the LIFO layers. Frankly, I think all of Mr. Barrett’s talk about ownership interest is nothing but a red herring. To be clear, I am not trying to take away the Company’s right and ability to recover the cost of extracted LIFO layers. My recommendation concerning the LIFO layers is to prevent the Company from also collecting 50% of the difference between the cost of the LIFO layers and the current market value of gas.

**2. Inconsistent with what actually occurred**

**Q. How does Mr. Barrett explain how your proposed reversal of the Company’s 50% share of the LIFO benefit is “inconsistent with what actually occurred”?**

A. Actually, I don’t think he does explain this. The closest he comes to an explanation of his position is when he states,

Both Mr. Zuraski and Mr. Mierzwa suggest that the financial impact of all LIFO layers of gas withdrawn during the GCPP period should be reversed, as if to suggest that all such withdrawals are improper in some way. But as shown in Appendix I attached to my testimony, *this is inconsistent with pre-GCPP history*, in which LIFO withdrawals took place in four of the five years 1994-

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<sup>42</sup> See Staff Exhibit 1.0, pp. 21-22 (lines 395-403).

<sup>43</sup> Nicor Exhibit 7.0, p 9.

1998, prior to the implementation of the GCPP. As I have stated, LIFO withdrawals are a normal part of operations.<sup>44</sup>

**Q. Is your recommendation concerning the LIFO-derived savings “inconsistent with pre-GCPP history, in which LIFO withdrawals took place in four of the five years 1994-1998, prior to the implementation of the GCPP”?**

A. No. In my direct testimony,<sup>45</sup> I already agreed with Mr. Barrett’s position that “Nicor Gas is allowed to manage the gas in inventory as part of strategies designed to reduce costs to its customers, including selling some gas in inventory.” (Barrett Direct, p. 31, lines 646-647) As I further clarified, “being allowed to manage gas in inventory as part of strategies designed to reduce gas costs is not the issue. The issue is whether there is any good reason to give the Company a share of the dramatic differences in the market value and the inventory value of gas withdrawn from the older LIFO layers of storage. In my opinion, there is no good reason to give the Company a share.”<sup>46</sup> I then went on to list reasons why the Company should not be given a share of the LIFO-derived savings (which I will not repeat here).<sup>47</sup>

Finally, I acknowledge that “LIFO withdrawals took place in four of the five years 1994-1998, prior to the implementation of the GCPP.” In fact, as I point out in my direct testimony, these pre-GCPP net withdrawals probably increased PGA costs in those years, because they were not withdraws from old low-cost LIFO layers, but from more recently created layers that were somewhat above the average index prices in those

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<sup>44</sup> Nicor Exhibit 7.0, pp. 13-14, emphasis added.

<sup>45</sup> Staff Exhibit 1.0, p. 26.

<sup>46</sup> Staff Exhibit 1.0, p. 26.

<sup>47</sup> Staff Exhibit 1.0, p. 27.

years.<sup>48</sup>

3. *Adjustments not properly run though the required GCPP calculation*

**Q. Mr. Barrett complains that you do not “flow the adjustment through the GCPP calculations.” Was this an error on your part?**

A. No. That is exactly what I intended. I do not deny that there were LIFO-derived “savings” relative to the PBR benchmark. My recommendation is to prevent the Company from collecting 50% of those savings for shareholders. Instead, I recommend that 100% of the LIFO-derived savings be retained by ratepayers. That is not an error.

4. *Arbitrary assumptions*

**Q. Does Mr. Barrett explain which of your assumptions were “arbitrary”?**

A. No. However, in discussing my calculation of the LIFO-derived savings, Mr. Barrett states that “Mr. Zuraski himself admits that he is forced to make assumptions about when withdrawals actually occurred,” assumptions that Mr. Barrett characterize as “unreasonable,” resulting in a “biased” calculation.

**Q. Were these assumptions unreasonable?**

A. No. Furthermore, if I may make a couple of corrections to Mr. Barrett’s slightly inaccurate restatement of my testimony, what I “admitted” was that anybody has to make assumptions about when net withdrawals actually occurred. Indeed, both Mr. Barrett and Mr. Feingold make two different sets of such assumptions, in their independent calculations of the LIFO-savings. Mr. Barrett computes LIFO-derived savings of \$8,474,187 and \$4,070,481, for 2000 and 2001 respectively; while Mr. Feingold

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<sup>48</sup> Staff Exhibit 1.0, pp. 37-39.

computes them to be \$17,337,441 and \$19,089,842, for 2000 and 2001, respectively.

Perhaps Mr. Barrett believes Mr. Feingold's assumptions are unreasonable.

**Q. What assumptions do Mr. Feingold and Mr. Barrett make in their computations of the LIFO-derived savings?**

A. I have already discussed Mr. Feingold's computations of the LIFO-derived savings (see Section IV.G above). To briefly summarize, Mr. Feingold assumes that net withdrawals (or net injections for 2001) were portioned equally over those months in which withdrawals exceeded injections (or vice versa for 2001). He does this by taking the simple average of the market index prices that prevailed during those months in which Nicor Gas had net withdrawals (for 2000 and 2002) or net injections (for 2001). This simple average is multiplied by the annual net withdrawals (or injections) to get what he calls "Replacement Gas Costs" in RAF-R1. He subtracts from Replacement Gas Costs the product of annual net withdrawals (or injections) and the average cost of the LIFO layer(s) being depleted (for 2000 and 2002) or depleted (for 2001).

In contrast, for 2000 and for 2002, Mr. Barrett assumes that net withdrawals were portioned over all 12 months of the year, in proportion to the historical (1994-1998) pattern of gross withdrawals (the same proportions used for the GCPP's Storage Credit Adjustment calculations). Thus, he computes a weighted average of the market index prices that is different than my simple average of all 12 months, as well as Mr. Feingold's simple average of select months. Then, rather than multiply each of his weighted averages by annual net withdrawals in 2000 and 2002 (as done by both Mr. Feingold and myself), Mr. Barrett multiplies his weighted average by the difference between net withdrawals in each of those years (2000 and 2002) and net withdrawals in 1998.

524 **Q. Does Mr. Barrett explain why he subtracts the 1998 withdrawals in the above-**  
525 **described calculation?**

526 A. He provides no explanation in the body of his testimony. However, in his  
527 Appendix I, Mr. Barrett states,  
528 Mr. Zuraski has assumed that there should be no net withdrawals in 2000 and  
529 2002. However, in four out of five years in the 1994-1998 period, there were  
530 net withdrawals, with net withdrawals as high as 7.7 million MMBtu. Nicor  
531 should be allowed to have net withdrawals equal to at least this amount.

532 **Q. In reference to the above excerpt from Mr. Barrett's Appendix I, do you assume**  
533 **that there should be no net withdrawals in 2000 and 2002?**

534 A. No. I don't know where Mr. Barrett gets that idea.

535 **Q. Does Mr. Barrett explain why your adjustment (or anybody's adjustment) to**  
536 **remove the Company's 50% share of LIFO-derived savings should not apply to the**  
537 **portion that Mr. Barrett has identified as the maximum net withdrawals that**  
538 **occurred in the 1994-1998 period (i.e. 7.7 million MMBTU)?**

539 A. No. Furthermore, his proposal to subtract off this 7.7 million MMBTU does not  
540 make any sense to me.

541 **5. Bias**

542 **Q. How do you respond to Mr. Barrett's accusation of bias?**

543 A. Not only am I committed to providing unbiased analyses and recommendations to  
544 this Commission, I have no stake in the outcome of this case or in the level of Nicor's  
545 PGA.

546 **B. 2001 Storage Withdrawals**

547 **Q. In 2000, 2001, and 2002, you propose to increase the quantity of storage**

548 **withdrawals reflected in the Storage Credit Adjustment component of the PBR**  
549 **benchmark to reflect Nicor's indirect use of released NGPL storage gas. Mr.**  
550 **Barrett is silent with respect to your proposal for 2000 and 2002. In contrast, for**  
551 **2001, he argues that your proposal is "fundamentally incorrect" because "Under**  
552 **GAAP, there simply is no accounting justification for these adjustments."**<sup>49</sup> **How do**  
553 **you respond to this criticism?**

554 A. First, as I tried to make clear in my direct testimony, this is not an "accounting"  
555 adjustment. My proposal does not affect the gas cost and inventory accounting  
556 associated with the above-cited storage transactions. My recommendations apply only to  
557 the computation of the benchmark. Hence, I do not see any conflict with accounting  
558 rules.

559 Second, it is interesting that Mr. Barrett's concern is limited to my adjustment to  
560 the 2001 benchmark. If my proposal were "fundamentally incorrect," one would think it  
561 would suffer from this defect in all years. Notably, my adjustment increases the  
562 Company's PBR savings in 2000 and 2002, and only decreases them in 2001.

563 **Q. In your computation of Nicor's indirect use of released NGPL storage gas during**  
564 **the 2000-2002 PBR period, Mr. Barrett takes issue with your use of average 1995-**  
565 **1998 NGPL withdrawals. Why did you use such an average?**

566 A. First, I was forced to employ some kind of proxy, because the Company claimed  
567 not to have its partner's actual NGPL withdrawals during the 2000-2002 period. Second,  
568 Mr. Barrett is correct that I did not include the 1994 data (which were also part of the

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<sup>49</sup> Nicor Exhibit 7.0, p. 16.

base period used in the 99-0127 case to establish the benchmark). I simply did not have the 1994 data. I would further note that Mr. Barrett does not provide the 1994 data as part of his testimony.

**Q. Mr. Barrett also claims that you make an error in the calculation for 2000 by including an inappropriate deduction for virtual storage. Is that true?**

A. It appears as if this may have been my error. Furthermore, eliminating the inappropriate deduction for virtual storage results in the Nicor's use of purchased storage withdrawals being greater than the 1995-1998 historical average. Hence, there is no need for any adjustment in 2000. My revised Attachments 1 and 2 reflect this change.

**Q. Mr. Barrett states that "the withdrawal amounts proposed by the Staff and Intervenors are merely theoretical, speculative, unsupported and do not reflect actual events."<sup>50</sup> Do you agree with this assessment of the withdrawal amounts that you propose for the Storage Credit Adjustment?**

A. No. There is nothing theoretical about the Company releasing storage capacity to a third party for purposes of managing that capacity. There is nothing speculative about the Company's purchases from those third parties including purchases supported by that released capacity. There is nothing unsupported about the notion that the Company's gas costs would be normally affected by storage injections and withdrawals due to seasonal differences in gas market prices (the Company proposed the SCA because of that). Finally, actual events included a significant seasonal price difference in 2001, which is when the Company and its partners had the opportunity to use that storage to

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<sup>50</sup> Nicor Exhibit 7.0, p. 20.



significantly reduce the cost of gas to ratepayers.

**C. Imputed Carrying Costs**

**Q. Mr. Barrett testifies that you provide no basis for computing a disallowance for carrying charges included in the cost of gas, associated with the released NGPL capacity. What is the basis for your adjustment?**

A. The basis was explained in my direct testimony as follows:

Instead of buying gas during the injection season, leaving it in storage (incurring carrying costs) and withdrawing it during the withdrawal season, the Company released capacity to third parties and allowed them to perform all of the above steps. When the Company bought the gas during the withdrawal season, it paid explicit or implicit carrying charges embedded in the price. ...

As noted above, it is common Commission practice to include a return on the cost of gas in storage inventory in base rates. To avoid double-recovery, the Commission's PGA rules prohibit the inclusion and recovery of carrying charges on gas in storage. However, with the released storage capacity, the Company either explicitly or implicitly paid carrying charges to vendors for gas delivered to the Company. These explicit and implicit carrying charges were included in the ultimate price paid by the Company, included in the PGA, and recovered from ratepayers. Thus, Staff recommends adjustments to remove these carrying charges from the PGA for the years 1999 through 2002.

**Q. Mr. Barrett testifies that you provide no source for the 7% factor that you used in your computation of the above-described carrying charges. Why did you use 7%?**

A. I adopted 7% as a conservatively low interest rate after examining the following information:

Staff asked the Company to indicate how much money is collected through base rates for the purpose of recovering carrying costs associated with storage. The response, sent on or about August 12, 2002, indicated that in its 1995 general rate case, an interest rate of 9.67% would have been applicable to this expense.

In a Company document, entitled "DSS Management Potential Benefits and

Risks,” Nicor assumes borrowing rates of 5.5% (short-term) and 16.57% (long-term) to estimate the annual savings of the DSS management deals.<sup>51</sup>

In September of 2002, I looked at the Federal Reserve’s data on corporate bonds and discovered that the “Rate of interest in money and capital markets, Moody's Investor Service, Long-term or Capital Market, Private, all industries, AAA Rating, Not seasonally adjusted, Monthly” averaged 7.62% in 2000 and 7.08% in 2001.<sup>52</sup>

**D. Timing of IMD Transaction**

**Q. Mr. Barrett provides rebuttal testimony concerning your recommended adjustment associated with the December 1999 sale of gas to IMD.<sup>53</sup> Does his testimony cause you to alter your recommendation?**

**A.** No. While Mr. Barrett focuses on accounting issues, my testimony is focused on how the Company increased gas costs as a result of this transaction. The Company’s accounting restatement may have provided a better measurement of the costs incurred, but it does not indicate whether those costs were too high or not.

**E. Affiliate Discount**

**Q. Mr. Barrett provides an assessment of the adjustments proposed by Mr. Mierzwa and you that are associated with the January 2000 transaction between the Company and its affiliate, Enerchange. Mr. Barrett testifies that the order-of-magnitude difference between your adjustment and Mr. Mierzwa’s adjustment**

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<sup>51</sup> NIC 003205.

<sup>52</sup> For purposes of this rebuttal testimony, I just updated my file and found that the 2002 average was 6.49%.

<sup>53</sup> Nicor Exhibit 7.0, pp. 24-25.

638 **“alone demonstrates the after-the-fact and *ad hoc* nature of this claim.”<sup>54</sup> How do**  
639 **you respond to this testimony?**

640 A. My analysis was a two-step process. In the first step, I determined that the  
641 transaction was improper, based only on information known at the time of the  
642 transaction. However, in the second step, where the adjustment is computed, my analysis  
643 computes the actual harm to ratepayers that arose from the transaction. In contrast, Mr.  
644 Mierzwa’s adjustment is based only on information available at the time of the  
645 transaction.

646 With respect to the adjustment being *ad hoc*, I have no qualms with that  
647 characterization. Unless we are to somehow prove (or to merely assume) that all  
648 transactions are improper (or, alternatively, that all transactions are proper), regulators  
649 have no choice but to assess the propriety of transactions on a case-by-case basis  
650 (transaction-by-transaction).

651 **Q. Mr. Barrett states that**

652 **In taking positions in forward markets and pursuing asset optimization**  
653 **strategies, as encouraged by the GCPP, Nicor was fully expected to have both**  
654 **gains and losses on its individual transactions during the course of the year.**  
655 **Mr. Zuraski’s claim for refund seeks to selectively review transactions, and**  
656 **only remove the losses.**

657 **Do you agree with Mr. Barrett’s assessment that your “claim for refund seeks to**  
658 **selectively review transactions, and only remove the losses”?**

659 A. Absolutely positively NOT. I have seen records showing hundreds of  
660 transactions that ended up as losses, during the time period under review. Staff is not  
661 seeking to exclude all of those losses. Only when the transaction was improper from the

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<sup>54</sup> Nicor Exhibit 7.0, p. 26. By “this claim,” I assume that Mr. Barrett is referring to my proposed adjustment.

beginning does Staff recommend that the losses be excluded from the PGA.

**F. Weather Insurance**<sup>55</sup>

**Q. Like Mr. Feingold, Mr. Barrett objects to your additional adjustment of \$2,057,525 associated with the Company's deal with Aquila to trade a gas sale discount (to Aquila) for a weather insurance discount (for Nicor shareholders). Have Mr. Barrett's objections caused you to alter your recommendation with respect to this additional adjustment?**

**A.** No. I still recommend, consistent with the Lassar Report, that Nicor be ordered to refund to ratepayers an additional \$2,057,525, associated with the Aquila weather insurance deal. My reasoning for this recommendation was fully explained in my direct testimony.<sup>56</sup> Furthermore, like Mr. Feingold, Mr. Barrett should consult with Nicor witness Moretti, who proposes an additional refund of roughly the same magnitude (\$2.05 million) "related to the purchase of weather insurance from the company called Aquila."<sup>57</sup>

**G. Infield Transfers**

**Q. Mr. Barrett objects to your proposal to eliminate the Company's exclusion of infield transfers from the computation of Nicor's storage withdrawals. He invokes GAAP, again, and suggests that the post-whistleblower accounting restatement corrected the previous haphazard computation of infield transfers, replacing it with a more**

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<sup>55</sup> Nicor Exhibit 7.0, pp. 29-31.

<sup>56</sup> ICC Staff Exhibit 1.0, pp. 68-76.

<sup>57</sup> Nicor Exhibit 10.0, especially p. 2, lines 36-37.

proper, consistently applied calculation.<sup>58</sup> How do you respond to this testimony?

A. While Staff accounting witness Mary Everson will also address the relevance of GAAP to this issue, I would just remind Mr. Barrett that the Company never computed in-field transfers and never subtracted them from Company withdrawals, prior to the PBR program. Hence, if GAAP is relevant to the in-field transfer issue, then clearly the Company was violating GAAP in all the decades prior to the PBR program.

More fundamentally, though, I do not see how GAAP can be relevant to the issue, since the in-field transfers have absolutely no impact on gas costs. They are only relevant to the computation of the PBR benchmark. As I noted in my direct testimony, by excluding in-field transfers, the Company basically took it upon itself to unilaterally alter the Commission-approved PBR benchmark (without so much as notifying the Commission or the Commission Staff). With the restatement, the Company dressed up its in-field transfer calculations. However, even if the revised method now meets Mr. Barrett's standards for in-field transfer calculating, the Company should not be rewarded for making such unilateral changes to the Commission's PBR order.

#### **H. Hub Revenues**

**Q. Mr. Barrett states that the Chicago Hub storage loans involve no PGA recoverable gas costs.<sup>59</sup> Do you agree?**

A. No. The cost of natural gas is a PGA recoverable cost. The Hub's loaning of natural gas therefore includes the use of a PGA recoverable cost. Mr. Barrett is incorrect to state that the gas loans only used storage capacity. They used storage capacity as well

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<sup>58</sup> Nicor Exhibit 7.0, pp. 31-32.

as natural gas. Furthermore, as explained in my direct testimony, they do not fit the description of “Hub Services” that existed when Nicor was permitted to exclude Hub Service revenues from the PGA.<sup>60</sup> That description clearly excluded the provision (or loaning) of natural gas. Thus, Mr. Barrett’s rebuttal testimony does not cause me to alter my recommendation with respect to the inclusion of storage loan revenue in the PGA.

**I. Calculation of the 2% Adjustment**

**Q. According to Staff witness Knepler (in his direct testimony), there should be additional refunds associated with lost storage gas (2% of withdrawals), the cost of which the Company has been including in the PGA. As reported in your direct testimony, you assisted Mr. Knepler in computing the magnitude of this lost storage gas cost. While this reduced gas costs recovered through the PGA, you did not account for that reduction in the computation of “savings.” Mr. Barrett criticizes you for not accounting for that reduction in the computation of “savings.” Why did you not account for that reduction in the computation of “savings”?**

**A.** Since, according to Mr. Knepler, the Company should have been excluding the cost of lost storage gas from the PGA all along (both before and after the PBR program was initiated), the PBR benchmark should have excluded such costs all along, as well. Hence, for purposes of computing savings, I left out the reduction in 2000 through 2002 costs arising from the 2% of withdrawals cost adjustment.

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<sup>59</sup> Nicor Exhibit 8.0, p. 33.

<sup>60</sup> Staff Exhibit 1.0, pp. 80-90.

**VI. Reply to Nicor Witness Lenart**<sup>61</sup>

**A. Nicor's Decision to Seek and Accept a PBR Plan**

**Q. Mr. Lenart attributes to you an accusation that Nicor developed its PBR proposal with a plan to liquidate the low-cost LIFO gas inventory layers as a strategy to meet or beat the benchmark. He furthermore rejects that accusation.<sup>62</sup> Is it your position that Nicor developed its PBR proposal with a plan to liquidate the low-cost LIFO gas inventory layers as a strategy to meet or beat the benchmark?**

A. Not quite. My position is a little more guarded than that. As explained below, I cannot completely rule out the possibility that, when the PBR plan was proposed, and throughout the 99-0127 docket, Nicor considered LIFO to be just insurance and not the primary means of generating PBR savings. However, I do find that possibility hard to believe, for the following reasons:

First, the Company decided to pursue the PBR program directly after a presentation of the Inventory Value Team Report ("IVTR"), which stated:

We recommend that the company "capture" the LIFO inventory value by filing and implementing a Gas Rate Performance Plan (GRPP) related to gas costs. We think the best way to release this value is to continue to unbundle our services to our customers (Customer Select) together with the use of 3rd parties (marketers). There is a critical need to act quickly with the inventory value issue since the pace of unbundling may cause us to start withdrawing the low-priced gas in two or three years. The GRPP meets the timing requirement in that the legislation is in place (unlike eliminating the PGA), the ICC staff has effectively supported the concept of a GRPP in the recent CILCO hearings, and a GRPP does not require a fundamental change in the way we conduct our business.<sup>63</sup>

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<sup>61</sup> Nicor Exhibit 8.0

<sup>62</sup> Nicor Exhibit 8.0, p. 3.

<sup>63</sup> Staff Exhibit 2.0, Attachment A, p. 1.

Second, in 2000, soon after the program began, the Company set up the so-called prefill deals, which were its main tools for controlling net withdrawals and tapping into the low-cost LIFO layers.

Third, as previously noted, Nicor did rely quite substantially on LIFO depletion for the production of savings throughout the life of the PBR.

Fourth, Mr. Lenart himself previously testified that

[illegible]

Mr. Lenart also indicated that he agreed with the IVTR's recommendation to

“capture” the LIFO inventory value by filing and implementing a Gas Rate Performance Plan (GRPP) related to gas costs.<sup>65</sup>

Fifth, it simply does not make any sense for the Company to have identified the old LIFO layers as a source of value, only to then shelve the IVTR's recommended plan

to extract that value. That is, no matter what other strategies the Company may have developed and deployed to generate PBR savings and profits, using the PBR to profit from old LIFO layers, as recommended by the IVTR, was still the profit maximizing thing to do. If they had 10 ways to generate savings, why just use 9 of them?

Furthermore, if selecting among the alternative ways to generate savings, why not pick

your *sure bets* first and your *long shots* last? LIFO was a sure bet. None of the

Company's witnesses have provided any rationale for why the Company would have held

back on deploying the LIFO strategy. In fact, most of them talk about how clever and

innovative it was.

<sup>64</sup> Discovery Deposition of Theodore Lenart, taken under oath on the 16th day of July 2003, p. 34.



On the other hand, I have also heard some Nicor employees state that they viewed LIFO just as a kind of insurance against the possibility that Nicor's other PBR strategies failed. Mr. Lenart now appears to share this view,<sup>66</sup> despite his previous testimony.<sup>67</sup> Furthermore, I have seen a memorandum, provided in response to discovery, suggesting that, at the end of the third quarter of 2000, the Company was expecting to have x x x x x x x x x x x x x x x x.<sup>68</sup> Hence, there is some conflicting information with respect to the issue of whether Nicor planned on using LIFO all along (no matter what), or just planned on using LIFO as insurance (if it found itself hard-pressed to maintain PBR profitability).

But so what? It doesn't matter. Nicor knew that LIFO could produce savings, either as the first or the last strategy to be deployed. It knew LIFO ameliorated the Company's risk. Yet, Nicor failed to inform the Commission. It failed to respond openly to CUB data requests that clearly should have elicited such intelligence. Even if the LIFO strategy could be construed as some improvement in the utility's performance (which it cannot<sup>69</sup>), Nicor should not be rewarded for sneaking it through the oversight process entrusted to the Commission.

**B. Patterns of Injections and Withdrawals**

**Q. Mr. Lenart states that the January 2000 sale to affiliate Enerchange "was not intended to manipulate the SCA" and that it was a reaction to Nicor and ratepayers**

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<sup>65</sup> Discovery Deposition of Theodore Lenart, taken under oath on the 16th day of July 2003, p. 26.

<sup>66</sup> Nicor Exhibit 8.0, p. 6, lines 108-111.

<sup>67</sup> See notes 64 and 65, above.

<sup>68</sup> NIC 003161

<sup>69</sup> See page 16, herein. Also see Staff Exhibit 1.0, pp. 21-22 (lines 394-403), and p. 27 (lines 514-527).

788 **being at significant risk due to decreased withdrawals in January.<sup>70</sup> How do you**  
789 **respond?**

790 A. At one point, Mr. Lenart says that this transaction had nothing to do with beating  
791 the SCA, while at another point he contradicts himself, by acknowledging, “Because the  
792 SCA assumes that 26% of total annual GCPP withdrawals are withdrawn in January,  
793 decreased withdrawals in January could put Nicor and our ratepayers at significant  
794 financial risk.”<sup>71</sup> Furthermore, he never does satisfactorily explain how Nicor ratepayers  
795 were at risk. Indeed, under the Company’s alternative tack, ratepayers later experienced  
796 a loss of \$4.2 million, which would seem to contradict the notion that the transaction  
797 reduced (as opposed to increased) ratepayer risk.

798 Finally, in evaluating Mr. Lenart’s rebuttal testimony, I performed a comparative  
799 risk analysis. As shown in Table 3, my analysis suggests that ratepayers were under  
800 greater risk due to the Enerchange transaction than they were due to the mismatch  
801 between the SCA’s assumed 27% of withdrawals occurring in January and the lower  
802 percent of withdrawals that would have occurred (in the absence of the Enerchange  
803 transaction). In particular, there was more downside potential associated with the  
804 Enerchange deal than there was with the SCA benchmark. Reading left to right, the table  
805 compares (a) the potential savings or losses that could have resulted from the mismatch  
806 in SCA weights arising from lower January withdrawals, to (b) the potential savings or  
807 losses that could have resulted from the Enerchange sale.

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<sup>70</sup> Nicor Exhibit 8.0, p. 19.

<sup>71</sup> Nicor Exhibit 8.0, p. 19.

**Table 3. SCA Weighting Mismatch Risk versus Enerchange Deal Price Risk**

Mismatch between the SCA's Fixed and the Actual Withdrawal Percentages											Enerchange Deal	
		Potential Savings (Losses)									Delivery Month Spot	Potential Savings (Losses)
		Winter Spot										
		1.00	2.00	3.00	4.00	5.00	6.00	7.00	8.00	9.00		
Summer Spot	1.00	(3.10)	(1.03)	1.04	3.11	5.18	7.25	9.32	11.39	13.46	1.00	4.31
	2.00	(3.01)	(0.94)	1.13	3.20	5.27	7.33	9.40	11.47	13.54	2.00	1.31
	3.00	(2.93)	(0.86)	1.21	3.28	5.35	7.42	9.49	11.56	13.63	3.00	(1.69)
	4.00	(2.84)	(0.77)	1.30	3.37	5.44	7.51	9.58	11.65	13.72	4.00	(4.69)
	5.00	(2.75)	(0.68)	1.39	3.46	5.53	7.60	9.67	11.74	13.81	5.00	(7.69)
	6.00	(2.66)	(0.59)	1.48	3.54	5.61	7.68	9.75	11.82	13.89	6.00	(10.69)
	7.00	(2.58)	(0.51)	1.56	3.63	5.70	7.77	9.84	11.91	13.98	7.00	(13.69)
	8.00	(2.49)	(0.42)	1.65	3.72	5.79	7.86	9.93	12.00	14.07	8.00	(16.69)
	9.00	(2.40)	(0.33)	1.74	3.81	5.88	7.95	10.02	12.09	14.16	9.00	(19.69)

Assumptions concerning above table: Spot prices are in \$ per MMBTU. Savings and losses are in millions of dollars. The volume of the January mismatch or the Enerchange deal is assumed to be 3 Bcf. Summer is assumed to be May through October (the months where the SCA fixed withdrawal weights exceed the fixed injection weights) and Winter is assumed to be all the other months (except January, which was already known).

The analysis shows much more significant negative savings for ratepayers due to the Enerchange deal. Specifically, losses would grow with the higher spot prices in the delivery month(s). Notably, while the Company would share 50% of that downside potential due to the PBR, its affiliate, Enerchange, could make up for it by selling the gas in the market at those higher spot prices. That is, if Enerchange hedged half the volume, its profits or losses on the unhedged half would completely offset the losses or profits experienced by Nicor Gas due to the PBR's 50% sharing rule.

## **VII. Reply to Nicor Witness Harms<sup>72</sup>**

### **A. Discovery**

**Q. At lines 170-187 of his rebuttal testimony<sup>73</sup>, Mr. Harms defends the Company's decision to withhold the Inventory Value Team Report ("IVTR") from the other**

<sup>72</sup> Nicor Exhibit 9.0

<sup>73</sup> Nicor Exhibit 9.0, pp. 8-9.

parties during Docket No. 99-0127, even after CUB issued a data request (CUB 27), asking that Nicor “Please provide a copy of all projections, analyses and studies prepared which examine the extent to which the Company may profit under its proposal. Include copies of all communications which discuss the profit potential of the Company’s proposal.” Does Mr. Harms present any compelling reasons to substantiate Nicor’s claim that the IVTR was not responsive to this CUB data request?

A. No. Mr. Harms opines that the IVTR includes no “projections, analyses, or studies” of the “potential profits” from any “PBR” program. On the contrary, any reasonable person reading the IVT Report would agree that it is all about how to *profit* from withdrawal of old LIFO layers, most particularly through the establishment of a PBR. It certainly *analyzes* or *studies* the issue and, at least indirectly, provides a *projection* of how much profit could be extracted from the low-cost LIFO layers. The very first page of the IVTR states, in part,

There is about 75 BCF of gas in these lower priced layers, with market value of about \$100-200 million in excess of cost. ... We recommend that the company “capture” the LIFO inventory value by filing and implementing a Gas Rate Performance Plan (GRPP) related to gas costs.

Mr. Harms’ contention that the IVTR was not responsive to CUB 27 is simply absurd.

**Q. At lines 188 to 196, Mr. Harms opines that the Buckets Reports (examples of which can be found in Attachment 2 to my rebuttal testimony) were not responsive to CUB data request 1.17 (in the instant docket).<sup>74</sup> Do you accept his stated reasons for this opinion?**

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<sup>74</sup> Nicor Exhibit 9.0, p. 9.

848 A. No. First, he notes that CUB 1.17 did not “specifically” ask for “documents.”  
849 Regardless of whether the data request asked for documents, Nicor was obliged to  
850 provide all information in its possession which was responsive. The information could  
851 have been provided in the form of a narrative containing the information in the Buckets  
852 Reports, or Nicor could have responded with the Buckets Reports themselves. In  
853 pertinent part, CUB’s data request asked the Company to “*identify or estimate*” savings  
854 derived from numerous activities, including “*Managing storage differently*” and a catch-  
855 all category of “*Other (describe)*” activities. Nicor seems to have interpreted the request  
856 as only requiring the Company to identify or estimate the savings, after which the  
857 Company had no responsibility to then report the information to CUB in some form of  
858 document. Or perhaps Nicor interpreted the request as pertaining only to new attempts to  
859 identify or estimate, and not to old attempts that had already been documented, as in the  
860 Buckets Reports. Either interpretation by Nicor would be unreasonable.

861 Second, Mr. Harms argues that the Buckets Reports only included, in his opinion,  
862 “rough estimates.” However, the data request asked for “estimates.” It did not ask for all  
863 estimates other than the rough ones. There would have been nothing wrong with the  
864 Company providing the Buckets Reports with whatever accuracy disclaimers the  
865 Company saw fit to include. Thus, in my view, the Company had no legitimate reason to  
866 withhold the Buckets Reports from its response to CUB 1.17.

867 **B. Did Ratepayers Benefit Under the GCPP?**

868 Q. Mr. Harms is asked, “Did the GCPP benefit customers?” His response is to note

that the program showed positive \$17 million in savings relative to the benchmark.<sup>75</sup>

**Do you agree?**

A. No. First, according to Nicor Witness Moretti's rebuttal testimony, the Company owes ratepayers an additional \$4.1 million (see next section), implying that the \$17 million of "savings" referenced by Mr. Harms (which comes from the Company's direct testimony) overstated even the Company's current version of savings by \$8.2 million.

Second, without LIFO-derived savings, both Staff and the Company show negative savings.

Third, even with the LIFO-derived savings, Staff's adjustments to the benchmark and to costs result in revised savings of negative \$10 million.

**VIII. Reply to Nicor Witness Moretti**<sup>76</sup>

**Q. Mr. Moretti proposes to effect an additional refund through the PGA of \$4.1 million. He states, "Of the total, \$2.05 million is related to carrying costs paid to the entity known as IMD as part of its cost to manage Nicor Gas' DSS storage, which was sold to IMD in December 1999. The remaining \$2.05 million is related to the purchase of weather insurance from the company called Aquila."<sup>77</sup> Do you agree with Mr. Moretti's proposed additional refund related to the Aquila transaction?**

A. I agree, except for a minor difference over the precise amount. In his testimony, Mr. Moretti provides no details of the Company's calculations supporting his figure of

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<sup>75</sup> Nicor Exhibit 9.0, p. 11 (lines 223-226).

<sup>76</sup> Nicor Exhibit 10.0

<sup>77</sup> Nicor Exhibit 10.0, especially p. 2, lines 33-37.

\$2.05 million. My calculations are shown on page 71 of my direct testimony.<sup>78</sup>

According to my calculations, the amount that should be refunded is \$2,057,525, which is just \$7,525 (or 0.4%) more than Mr. Moretti's figure. Nevertheless, despite this minor difference, I am glad to see that at least one of the Company's witnesses agrees in principle with the need for this adjustment. Oddly enough, Mr. Feingold and Mr. Barrett criticize Mr. Mierzwa and me over precisely this same issue (see Sections IV.C and V.A, above).

**Q. Do you have any other comments with respect to Mr. Moretti proposal to effect an additional refund through the PGA of \$4.1 million?**

A. Yes. Mr. Moretti neither provided updated schedules reflecting this proposal nor indicated when the Company would be making the additional refund. Hence, I did not attempt to incorporate the additional \$4.1 million refund into my revised Schedule 1's depiction of the Company's position.

**Q. Does this conclude your testimony?**

A. Yes.

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<sup>78</sup> ICC Staff Exhibit 1.0, pp. 71, especially Table 13.